NOTES

WASHINGTON NOTES

THE WORLD CRISIS

It is possible there have never been two months in the history of the United States since the Civil War when so many and such far-reaching financial and commercial problems were suddenly presented to the government of the United States as have been offered during August and September of this year. Beginning with the sudden outbreak of the war, drastic and unprecedented fluctuations in securities, cotton, cereals, drugs and chemicals, and other commodities were witnessed. These were accompanied or followed by a sudden suspension of practically all communication with outside countries, due to the unwillingness of ship-owners to continue the operation of their vessels in consequence of fear of capture. The total annihilation of export trade for the time being, as well as the partial destruction of import business, produced serious financial and labor difficulties in the United States itself, and has since led to prospects of industrial reorganization and readjustment in many directions. It will be long before the actual results of this situation and the working out of what has been done in a number of lines are fully ascertained. In the meantime, the analysis of the conditions that have existed and the extent to which they have been met by legislation can be stated with accuracy, although without the possibility of positive opinions regarding the wisdom of what has been done or the immediate consequences to which the steps taken may be expected to lead. At the basis of the whole situation lies the financial problem that was forced to the front by the declaration of war between the principal European powers at the beginning of August.

CLOSING THE EXCHANGES

Hardly had the actual outbreak of war become known, when the closing of the European exchanges gave the signal for similar action in the United States. Immediately the New York Stock Exchange closed its doors (on August 1), and this example was shortly followed by the cotton and coffee exchanges, as well, of course, as by the Consolidated Stock Exchange. The immediate reason for the closing of the New York Stock Exchange was twofold: (1) Europeans, foreseeing a tremendous draft upon their resources, hastened to seek to sell investment securities in

what was practically the only great market untouched by war. To this end the representatives of the great European holders of American stocks and bonds cabled their bankers in New York to dispose of securities at practically any price that could be had. The process was in operation during the days before the closing of the Exchange and had already caused heavy shipments of gold to Europe. Had it been allowed to continue, it would have, almost certainly, deprived the United States of a very large proportion of its gold stock; (2) Stock Exchange operators who had obtained bank loans protected by collateral security saw that the reduction of prices on the Exchange which would necessarily follow the disposal of the immense quantity of shares rushing hither from Europe would effectually "wipe them out," while the banks which were "carrying" these persons understood that, if obliged to "call" the loans thus made, they would still further aggravate the pressure of selling orders and would bring about widespread ruin in the financial world. In the case of the Cotton Exchange, the condition was somewhat different because of the fact that the staple is owned in the United States and its sale brings gold to, instead of driving it out of, this country. But the condition of things with regard to the protection of loans based on cotton was identical with that existing on the Stock Exchange as concerned loans based on collateral.

EMERGENCY CURRENCY

The confessed closing of the exchanges, because of the danger of loss of gold and of depreciation of prices, naturally tended to arouse serious alarm in many minds, and withdrawals of cash both from the banks and from the Treasury began to be heavy. Almost simultaneous with this condition was the declaration of a so-called "moratorium" by most of the principal countries of Europe. This step prevented Americans who had maturing claims upon European countries from collecting the amounts due them until a date much later than they had expected. Hence, such persons were compelled to draw more heavily upon their home bank accounts and so far as possible to finance themselves through fresh loans at the banks. Fearing the heavy draft on their resources that was thus threatened, the New York banks almost immediately had recourse to the "national currency association" which had been organized after the adoption of the so-called Aldrich-Vreeland Act, but which had remained in a dormant, although not extinct, condition. Other banks promptly took like action. Applications were at once made to the government for the issue of emergency currency, and it was resolved to employ also an issue of clearing-house certificates. At

a conference between Secretary of the Treasury W. G. McAdoo and a group of New York bankers representing the clearing-house, which occurred in New York City on August 2, both these methods were authorized, and on the following day the work of issuing the certificates and notes was actively begun. It was found, however, that the Aldrich-Vreeland law, even as amended by the Federal Reserve Act of December 23, 1913, placed some serious obstacles in the way of the easy issue of currency. In consequence, a bill for the relief of this state of things was introduced in Congress and was signed by the President on August 4. This amendatory act reduced the tax on Aldrich-Vreeland notes for the first three months of their circulation to 3 per cent and raised the limit of issues to 125 per cent of capital and surplus. It also enabled the state banks affiliated with the federal reserve system to take out notes under certain specified conditions. While no public announcement was made of the issue of clearing-house certificates with regard to either their distribution or their amount, it is known that both in New York and elsewhere (by other clearing-houses) an enormous and probably unprecedented amount of such certificates was issued; and the emergency currency taken out under the amended legislation already referred to expanded so rapidly that by the opening of September more than $250,000,000 of it had been issued. The emergency currency was freely accepted by individuals, and banks in New York as well as elsewhere adopted the policy of paying it out whenever possible while holding gold, refusing to pay gold to customers except for good and sufficient cause shown.

RELIEVING THE FARMER

The relief to the commercial community produced by the issue of the emergency notes on the strength of paper as just described was not diffused throughout the country, and consequently complaint began to be heard from those who found themselves seriously affected by the inability to sell their crops and other products at regular prices following upon the cutting-off of export demand. Those most seriously affected were probably the cotton-growers of the South. About the middle of August, these growers undertook a campaign to obtain relief, presenting to the government two possible courses of action: (1) the valorization of the cotton crop upon the lines which have been traced by the Brazilian government in its experience with coffee, and (2) the making of loans upon the strength of cotton. Of these two courses the latter was the one which commended itself most strongly to the government, although Secretary McAdoo was at no time willing to countenance the plan of a direct government loan. Ultimately, at a conference held

at the Treasury Department, on August 24–25, and participated in by bankers, producers, and cotton brokers, it was announced by the Secretary of the Treasury that he would permit banks to present to their national currency associations warehouse certificates representing cotton estimated at a reasonable figure, as a basis for the issue of emergency currency of the same kind as was being paid out to those institutions which were able to present satisfactory commercial paper as the basis for their advances. Upon the demand of tobacco-growers and of those concerned in the naval-stores industry, their products were likewise subsequently included among those whose warehouse certificates were to be regarded as acceptable if offered as a basis for emergency issues. Thus the basis for the emergency notes was tremendously enlarged, and they were given a backing entirely dependent for its value upon the marketability of the cotton, tobacco, and naval stores, as well as upon the disposition of those (both individuals and banks) concerned in the making of the loan in question to terminate the "accommodation."

CHANGING THE NAVIGATION LAWS

While the financial problem was being dealt with in the way just described, an equally serious and difficult issue was presenting itself to the exporting branch of the community and through it to the farmers of the country. The suspension of steamship services and the withdrawal of tramp steamers from their usual field of operations immediately after the outbreak of war had practically isolated the United States. The difficulty at first seemed to be resident in the fact that, whereas foreign nations possessed merchant fleets of their own which habitually carried the commerce of the world, but were now unavailable, the United States, the greatest neutral nation on earth, possessed practically no ocean-going vessels carrying its own flag, and hence was unable to deliver its products abroad. As is well known to students of the merchant-marine question, the non-development of a merchant marine in the United States is due in part to the maintenance of very severe laws governing the employment of seamen, which are so shaped that compliance with them makes it impossible to operate a vessel profitably under the American flag, and in part to the high cost of shipbuilding, foreign ships, which can be built for much less, being denied registration under the American flag, except by act of Congress. The first movement toward relieving the export conditions, therefore, was seen in an effort to secure the repeal of the barriers to the registration of foreign ships. With this was speedily coupled a demand for a grant of power to the President of the United States to suspend the laws governing the employment of seamen for such

a period as he might deem wise. The further consideration of the question also developed the supposed necessity of providing a means of insuring vessels against the risks of war. Hence the adoption of an act on August 18 authorizing the registration of the vessels and giving to the President proper power for the suspension of the navigation laws, while war-risk insurance was provided for in another act, passed August 31, creating a Federal Bureau of War Risk Insurance. With but little delay, arrangements were made by vessel-owners for bringing under the American flag nearly one hundred ships (up to the middle of September), while inquiries and applications for war-risk insurance amounted to about $15,000,000 up to the same date.

A less-well-advised scheme than any of the others is seen in the proposal which is being pressed in Congress to authorize the administration to purchase, at a cost not to exceed $30,000,000, a fleet of vessels to be commercially operated wherever conditions seem to demand them. As things have developed, the necessity for all of these shipping measures has been greatly minimized, while their efficacy has been materially brought into question. It was only a few days after the definite opening of the war that the British admiralty announced the establishment of a patrol of cruisers across the Atlantic. This patrol, strong enough to safeguard against capture actually neutral vessels engaged in legitimate business, has been steadily maintained and has led to the resumption of many regular steamship services. On the other hand, the warring nations of Europe have indicated a strong indisposition to permit the government of the United States to purchase from their enemies vessels belonging to the latter, and therefore susceptible to capture, for the purpose of operating them safely under a neutral flag. The belligerents have rightly maintained that this proposal was entirely in defiance of the canons of international law affecting the subject, and they have therefore declined to recognize the neutrality of vessels so purchased, unless used exclusively for trade with another neutral nation as, e.g., in trade between the United States and South American nations. The purchase of vessels by the government itself has been looked upon, not only by foreigners, but also by well-informed citizens of the United States, as likely to intensify in a high degree the difficulties which might grow out of the purchase of these vessels, under any conditions, by citizens of the United States.

NEW REVENUE MEASURES

One of the most embarrassing conditions produced by the war is seen in the effect it had upon the revenue condition of the government. The almost total suspension of importations at the opening of hostilities was

followed by a slight recovery, but this recovery was not sufficient to hold out hope of any restoration of the original income figures. Within two weeks after the definite opening of the hostilities, it was estimated by good authorities that the loss of revenue would amount to fully $100,000,000 during the fiscal year just beginning. This of course necessitated the finding of some new means of getting income, and, after a consultation among the administration and congressional leaders, it was determined to ask for the enactment of special war taxes. President Wilson read to Congress a special message on that subject on September 4, and immediately the problem of providing the desired $100,000,000 was taken up. From the outset, differences with respect to the proper objects of taxation to be selected prevailed among those at work on the subject. The measure was of more importance than was indicated even by the large sum of money Congress set out to raise. United States legal-tender notes or greenbacks are dependent for their convertibility into gold upon a fund of $150,000,000 held in the Treasury. This fund must be replenished whenever the presentation of greenbacks for redemption draws it down below its normal amount. To effect such restoration of the fund the Secretary of the Treasury may take gold from the general receipts of the department, substituting the redeemed greenbacks therefor in equal amounts, or may sell bonds for gold. The customs receipts have heretofore been the only sure source from which gold could be obtained in a revenue way, and the falling off of customs naturally and inevitably reduces the flow of gold into the Treasury. Thus the question is raised whether the new taxes will be made payable in lawful money only or whether it will be permitted to contributors to pay them in bank notes or any description of currency they may have on hand. In the absence of a steady supply of gold from current receipts, it may be expected that the Treasury will be forced to a gold loan because of the constant and heavy presentation of greenbacks and bank notes for redemption. Such presentations inevitably mean the very great depletion of the resources of the department and the permanent reduction of gold both in the redemption fund and in the general fund, unless some effective restoration of the amounts of these funds is brought about. It remains to be seen how this phase of the situation will be met by the new tax law, if at all.

THE FEDERAL RESERVE BOARD

While the country and the administration have thus been beset by the most serious and far-reaching problems of finance and commerce, the new banking system provided for under the Federal Reserve Act has

been in process of organization. Very serious delay in the confirmation of the members of the Federal Reserve Board put off the organization of that body until August 13, when it assembled for the first time in an official manner, although prior to that date work had been carried on by those members of the board who had earliest received the favorable vote of the Senate. Upon organization, the Reserve Board found itself obliged to consider the immediate financial problems growing out of the European war, and with these its attention was for the first three weeks of its existence almost wholly absorbed. During that period, it was felt, nothing would have been gained by an attempt to organize the new banks, inasmuch as such an effort would have still further complicated the serious conditions by which the member banks of the country were confronted. During this preliminary period of waiting, and while engaged in the attempt to relieve the financial community to some extent through adjustments of existing law, and through provision for issues of emergency currency, the Reserve Board undertook the consideration of some amendments to the Federal Reserve Act, notably the provision for the use of the notes of reserve banks in reserves of member banks, the permitting of domestic acceptances by member banks, and some other changes which have long been desired by certain interests. These demands have not met with favor thus far in Congress, that body being evidently disposed to limit itself to the changes in the Aldrich-Vreeland law, and the other modifications of existing provision for note issues, already indicated. Upon convening, the board received a report relating to the organization of the new banks which had been prepared by a preliminary committee on organization appointed for that purpose. In this report was presented a discussion of the proper location to be given to the reserve banks, and then a complete plan of organization, including provision for the definition of commercial paper, the working out of a complete clearing system, the establishment of a uniform system of accounting, the adoption of suitable by-laws, and a variety of other topics of like scope and importance. This report was at once taken under advisement with a view to determining how far the recommendations it contained would be capable of actual application in the organization of the new system. The most serious problems to be considered are those relating to the definition of commercial paper, and the application and working out of the system of clearing checks at par with only an actual cost charge for exchange and collection. The appointment of the new directors to represent the government upon the boards of the several reserve banks (three to be named for each bank) was also among the first topics of consideration.